DOW THEORY LETTERS INC.

RICHARD RUSSELL
P.O. Box 1759
La Jolla, Calif. 92037

36 Letters per Year – $75 Annually

Registered with the Securities Exchange Commission

October 11, 1972 Letter 543

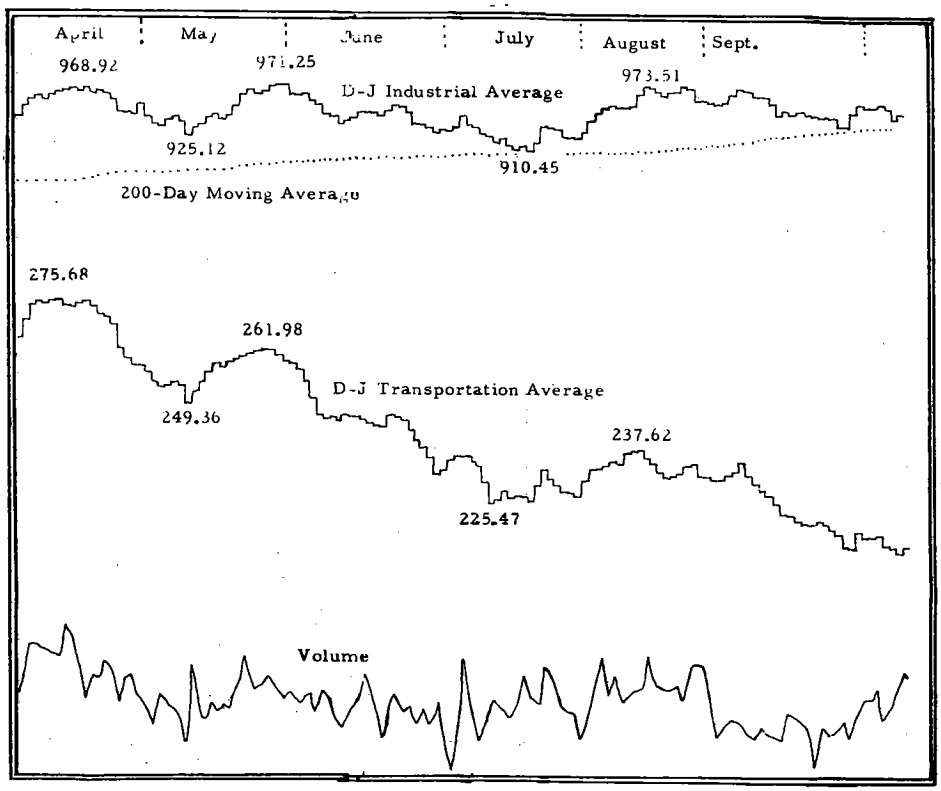
Sept. 29, Dow 953, PTI 925, A-D ratio -3.46
Oct. 6, Dow 945, PTI 920, A-D ratio -3.99

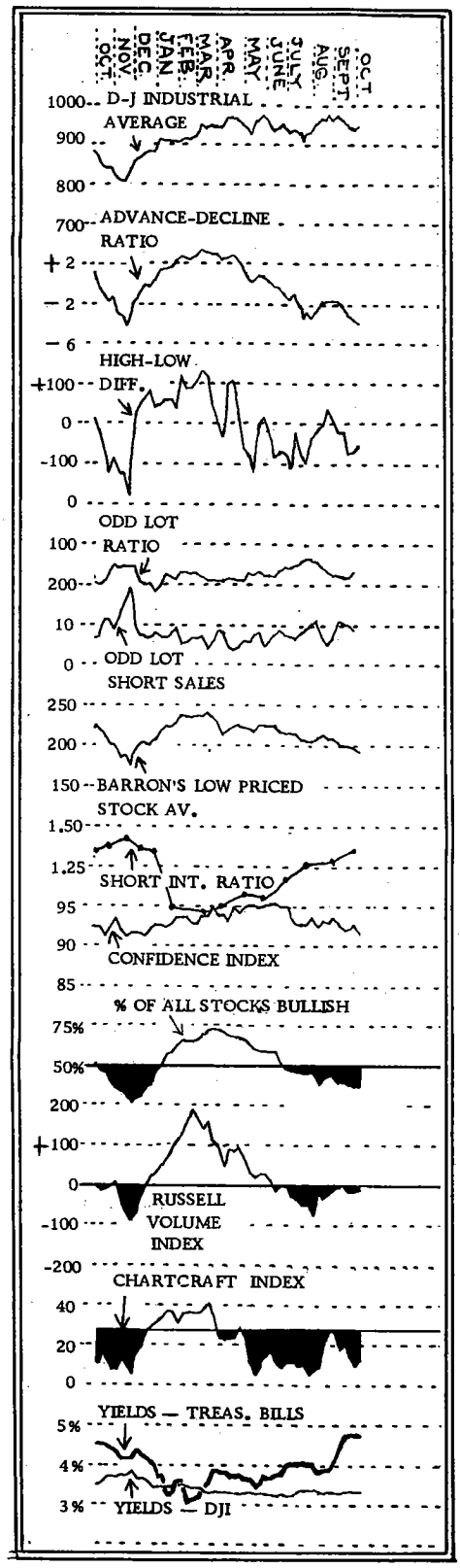
THE MARKET: For years Wall Street has been telling itself (and anyone else who would listen) what a great manager of money it was. It even sold the public on its managerial ability, and the mutual fund industry, reflecting the public's acceptance, saw its assets rocket past the $50 billion mark. Then those pathetic "Johnny-come-lately's," the public and private pension fund managers, joined the parade. Over the past year or so they have executed a complete about-face, with many of them piling into common stocks with as much enthusiasm as they exhibited in staying out of common stocks during the 1950's and '60's.

Of late, the financial community seems to have accomplished its fondest dream, with institutions accounting for 50% of NYSE volume (see page 2 chart), NYSE members taking up another 23% of volume, and the public sopping up the left overs. No longer does Mrs. Jones of Tulsa sell her 100 shares of Westinghouse to Mr. Smith of Nyack, the XYZ Fund swaps 100,000 shares of it with the ZYX Fund. And if 10 or 15 funds decide on the same day that they don't like Levitz, who do they sell it to? Can they sell it to the already exiting public?

Actually, I'm not saying that Wall Street has deliberately driven the public out. The fact is that each primary bull market ultimately ends, and a bull market ended in February, 1966. Since then we've seen the Government do everything but "underwrite" the stock market and still the Dow would not go over its 1966 peak of 995.15. Now, as happens during every primary bear market, the public is leaving. The mutual funds are getting redemptions monthly, the odd lotters are selling day after day, the public "wants its money back," and it still holds two-thirds of all the stock outstanding.

There's an old adage which says that "stocks always return to Wall Street." And I'm afraid that is what we are seeing now; the slow erosion, the day by day sagging of the advance-decline ratio, the daily list of new lows, the sinking volume, all





occurring under the "comforting" guise of the Dow Industrials bouncing around above 900. Who can get hurt with the Dow still up there? The answer is everybody in this unbelievably deceptive bear market.

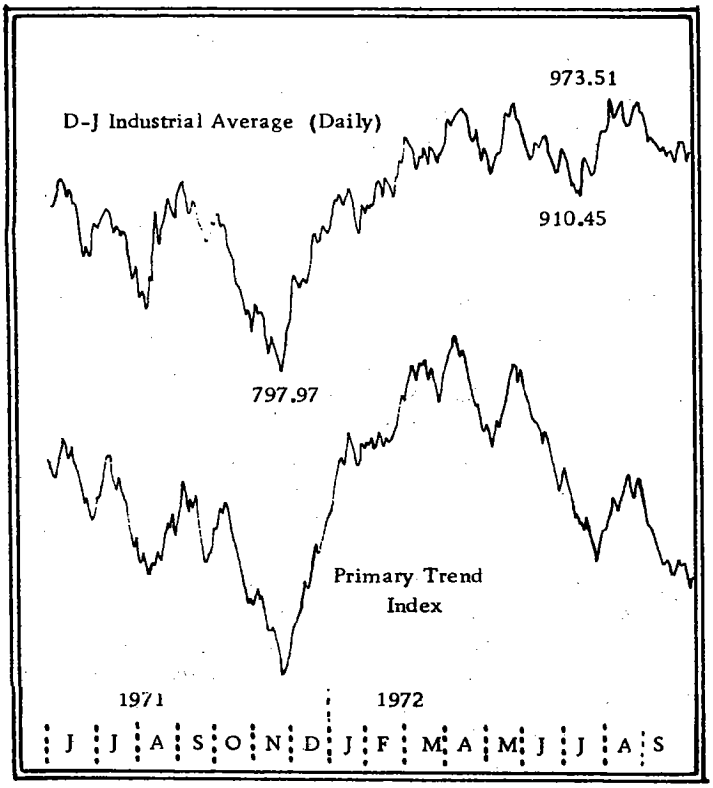
Ultimately, and we can be sure of this, the Dow stocks will go down too. But then it will all be obvious and out in the open. Meanwhile, the distribution goes on, slowly, subtly and often (as with Levitz, American Air Filters, or Wang Laboratories), not so subtly.

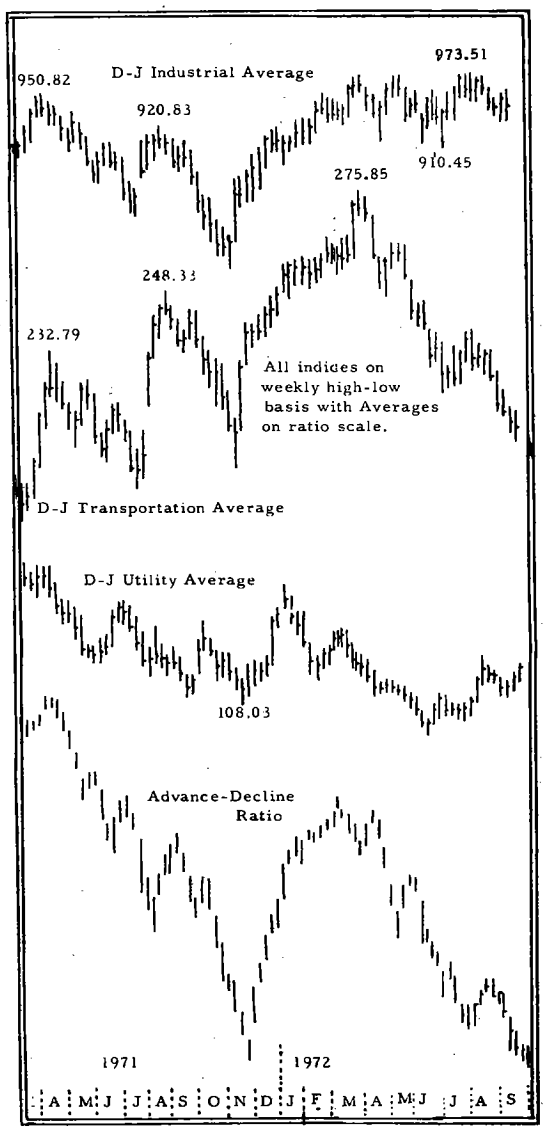
Last week I was most interested to receive the latest report from Investment Quality Trends (5453 La Jolla Blvd., La Jolla, CA 92037). This service monitors 350 high-grade common stocks listed on the NYSE. I Q Trends noted that "In our Summer Quarterly Review, published in June, 1972, there were 43,548 institutional holding shares of stock in the 350 Blue Chips listed in our publication. In the Fall Quarterly Review (September), that number had dropped to 35,160, a decline of approximately 20%."

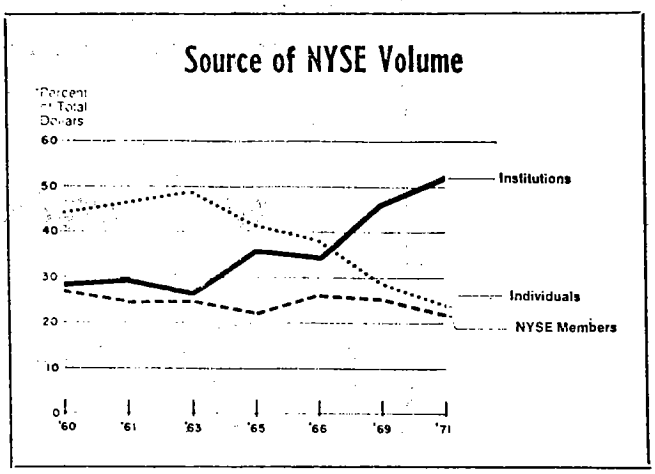
To me that is very significant. It suggests that the institutions are quietly getting out of even the highest-grade equities. Presumably this money could be going into bonds or cash, but who are the institutions selling their stock to? Or — have they been moving out of high-grade equities into lower grade commons and speculative shares? That is the mystery, but the whole phenomenon does not bode well for the Dow. The floor under this market, as I have been saying repeatedly, is getting thinner and thinner.

As to the actual market picture, if we turn to the daily chart of the Averages (page 1) we can see that the Transports continue to lead the decline. The two Averages established joint lows on September 26, Industrials at 935.73 and Transports at 216.15. Following a little rally, the Averages again turned down, and on October 4, Transports penetrated their late-September low to close at a new low for the year. Industrials, so far, have refused to confirm (confirmation would entail an Industrial breaking of the 935.73 level).

Aside from the question of whether Industrials will or will not confirm the Transport weakness, the rest of the technical picture continues ragged. I have included the weekly chart of the Averages together with the advance-decline ratio, and here we clearly see the stand-off in Industrials, the continuing weakness in Transports, and the fairly good rally in Utilities. At the bottom of the chart I show the A-D ratio, which on September 12,







broke to new low ground for 1972. The A-D ratio has continued down since then, and on October 8 it made a most bearish penetration, it broke under its (November) 1971 low. In doing so, it has wiped out almost the whole of its 1970-71 advance and is now within "shooting distance" of its 1970 bear market low (more about this in the next report).

A second chart shows the Dow and the Primary Trend Indicator (PTI), the indicator which is tabulated by compounding eight daily indicators including four common stock averages, a bond average, the A-D ratio, the high-low index and the most-active stocks index. This sensitive index of technical strength (or weakness) penetrated its July low on September 20, and it has continued down since then.

The A-D ratio, the PTI, as well as the Transportation Average are all critical gauges which should confirm the Industrial Average, both in direction and through preceding comparable levels. At this time, none of the three confirming indicators is in a position to do anything but widen the divergence should Industrials choose to rally from here. Thus the market has put itself into an increasing technical "bind," and in the past when this type of situation developed the ultimate major direction of the market was down. As I have stated in almost every Letter this year, I continue to believe that the market will confound the optimists and it will belie the glowing fundamentals (the latter, all having been discounted). In due time the Dow will embark on a major primary swing to the downside.

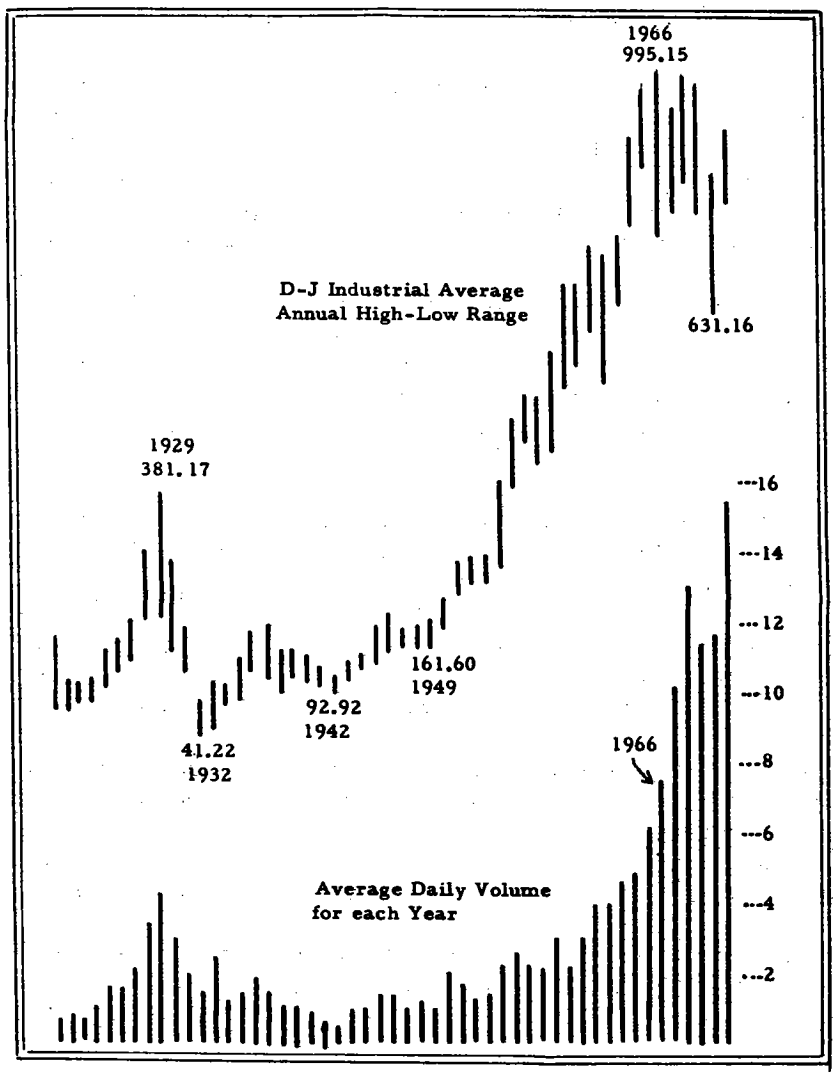
Many battered bulls are now arguing that so many stocks have been pulverized already in 1972 that it is probable that we have been in a medium-sized bear market (during 1972) which is now about over. I simply do not agree. Every bear market in history was finally expressed by a collapse in the D-J Averages. I do not think this one will be any different.

STRANGE THINGS: Red Buttons used to sing a song called "Strange Things Are Happening," and I have been thinking that the same song could be Wall Street's theme for 1972. Last week I included tabulations of the price range on the Dow going back to 1949. It was noted that so far, 1972 is producing a record narrow range (in percentages) for the senior Average.

Of course, we don't know what the rest of 1972 is going to show, but I do know that Wall Street is a land of contrasts and swings towards extremes. For instance, if the Dow holds roughly in its present 973-889 range of 1972 (a range of a mere 84 points) through the end of the year, I would guess that we are building up for a whopping large range in 1973. Obviously, bulls will immediately think in terms of 1200 on the Dow and bears will think in terms of 500. All I am saying in connection with this study is that 1973 is liable to be a year which includes a major (in extent) Dow swing.

I am including this chart which shows the annual high-low Dow Industrial ranges back to 1924. The chart is drawn to arithmetic scales so that the movements show in points, not in percentages. At the bottom of the chart I include average daily volume for each year from 1924 to 1972. This year is not yet included, but I would say that since May, 1972, average daily volume has run around 12 million shares, a drop of at least 3 million shares per day below 1971.

One most unusual phenomenon appears on this chart. Note that the Dow topped out over six years ago, in February, 1966. As a rule, volume tends to top out a little before or at times coincidentally with a major top in the Dow. But average daily volume has been



pushing up ever since 1966 (this year being an exception, of course), and this is the way I interpret the expanding volume which has come after the top. I take the rising volume since 1966 as part of an extended period of churning and distribution, all within what E. George Schaefer terms "Keynesian rallies." They are technically the counterpart of a man running up the down escalator. A lot of energy is burned, but he does not go over the top.

Now the question is, "What happens when the energy gives out? What happens when the funds and the institutions and the gunslingers run out of steam?" People forget that behind every institution are big people, medium-sized people and little people — but people. And people are slowly entering into the "calming down" (some call it the discouragement) stage. They're tired of taking losses in the market, they are going for the historically high interest rates, they are asking for their money back.

One argument which has been used over and over again is that when the public turns its stocks in, it is really a bullish factor because the public is always wrong. That observation is generally true in a primary bull market, and nobody can deny that the public bearishness of 1957, 1960, or 1962 was a huge technical plus for the market. But during a primary bear market when the public turns bearish on a long-term basis it is not a bullish phenomenon? Was the bearishness of late 1930 or 1931 a bullish factor on the market? Was the bearishness of 1938 and 1939 a bullish manifestation?

It should always be remembered that bearishness, when it occurs against the primary trend, is very bullish. But bearishness within a primary bear market is to be expected, and it is only when it goes to absolute extremes that we can use that bearishness as part of our considerations regarding the final primary bottom. But such bearishness should be of the blackest variety, such as "the market will never recover from this," or "Wall Street as a viable situation is finished" or "I'd rather put my money in a tin can in the back yard than in common stocks." When we hear such epithets, when blue chips at the same time are yielding 7% to 10%, when the most shocking news hardly budges the market on the downside, when volume is perhaps 10% of what it was at the top, that is the time when we can be reasonably sure that the market is ready to turn, the bear has grown old and is dying, and the seeds of the new bull market are about to germinate.

THE PICTURE: On every front huge problems confront the nation. Off hand, I can list five major problems which must be solved. Not one of them is near solution. I presume they will receive careful attention after the election.

(1) Vietnam: President Nixon has tried in vain to use Russian and Chinese "pressure" to force a solution in Vietnam. He has opened trade, put through a wheat deal which the authoritative "Money Manager" (formerly the Bond Buyer) calls a piece of "scandal and ineptitude." He has sent Dr. Kissinger scurrying back and forth to Paris so that hopes (if nothing else) for peace will remain high. It may now be dawning on the President that Hanoi thinks in terms of decades, while the West thinks in terms of days, weeks and months. Meanwhile, the war drags on, with Saigon under the absolute dictatorship of "President" Thieu. The latest US rumor has Thieu agreeing to resign under certain conditions, an offer which Thieu denies vehemently.

(2) Deficits in the national budget, and balance-of-payments deficits: These obviously cannot go on indefinitely. Putting a spending ceiling on the national budget is merely a political gimmick. It's not planning, and Mr. Nixon will have to drop this ploy shortly and institute a policy of a budget control which will not be inflationary and which the nation can afford. On the balance-of-payments, this massive problem will have to be attacked on the basis of fundamentals and from the standpoint of American productivity. So far, we have "attacked" it on the basis of demanding that our competitors restrict their imports and revalue their money. That policy is running into a stone wall.

(3) Gold: The US is in a dream world on the question of gold, but gold will take care of itself. It is only a matter of whether the US acts intelligently and takes the initiative on raising the price of gold or whether the price (as has happened so far) continues to climb.

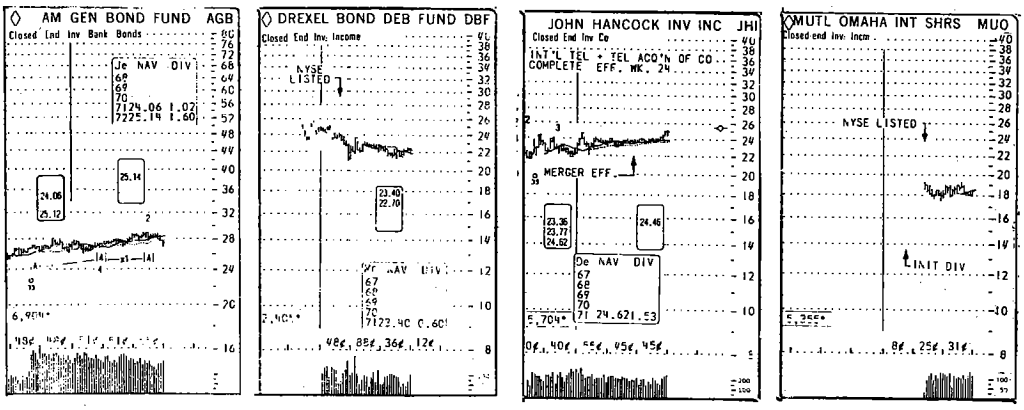
(4) Inflation: The US is comforting itself from the fact that Japan and Europe are now inflating rapidly while we are inflating less rapidly. Inflation is like heroin but there is no monetary methadone. Meanwhile, the ballooned US economy cannot operate without inflation; inflation is built into the nation as "a way of life." In that fact lies the seeds of chaos.

(5) Taxes: The Administration suggests (before election) that we can get by without an increase in taxes. But the need for new money (both for private and public use) in 1973 is going to be staggering. According to expert Henry Kaufman (Salomon Bros.) private debt was up $9.7 billion in '71, will be up $36.6 billion in '72 and is slated to be up $45.8 in the year ending June, 1973. And public needs for new money will be even higher! Where's the money coming from if not from higher taxes? Is it coming from the bond market? If it is coming from the latter, interest rates will go through and over the roof.

So there we are, a few of the unsolved problems as I personally see them. But we have enough there to at least provide a hint as to why the stock market is not behaving the way the bulls insist it must behave.

IMF MEETING: I must be a terrible doubter (of course I like to think of myself as a "searcher after truth"), but I just couldn't swallow all those lovely stories I had been reading about the way President Nixon and Treasury Secretary Shultz impressed everyone at the IMF meeting. It didn't make sense. Here we are, up to our ears in debt with "our" little remaining gold owed four times over to various IMF members, and we are telling the IMF to get rid of Mr. Schweitzer and to get rid of gold (of course, Europe and Japan can't get enough of the metal, much less get rid of it).

Then a subscriber was kind enough to send me this clip from the Sept. 25 Chicago Daily News which was headlined, "IMF Gives Cold Shoulder to Nixon." I must admit the story has the ring of truth about it (and I repeat again that the IMF may get down to real business after the US elections).


AM GEN BOND FUND AGB
Closed End Inv Bank Bonds
DREXEL BOND DEB FUND DBF
Closed End Inv. Income
JOHN HANCOCK INV INC JHI
Closed End Inv Co
MERGER EFF.
MUTL OMAHA INT SHRS MUO
Closed-end Inv. Incm
NYSE LISTED

CLOSED-END BOND FUNDS: One of the common questions received here is, "What do I do for income in a market like this one? I have gold shares for a hedge, I own some Treasury Bills, but the yields on these while historically high, are not high enough for my needs, bank certificates of deposit are a bit higher in yields than Treasury bills, and I don't know that much about bonds."

A new bond vehicle has come along which most subscribers are not aware of, and it is the bond fund. The funds I am referring to are traded as closed-end funds on the NYSE (in the same manner as say Tri-Continental).

There are four such funds now available, each of which may be purchased from your broker like any other stock with normal commission charts. They may at any time sell slightly above or below net asset value (NAV), depending on the market, and this can be checked with little trouble.

The first fund I will discuss is American General Bond Fund (see chart, courtesy of Quote Digest, PO Box 213, Wichita, Kansas 67201). This fund was formed in late-1970, and it invests only in nonconvertible bonds primarily of the four highest ratings. Its purpose is to produce income and to conserve capital. AGB is a subsidiary of huge American General Insurance Co.

Net assets per share are about $25, so at today's price of around $28, one pays a premium for this fund (plus commissions). Of interest to many who depend on income is that AGB pays interest monthly. Yield is over 7% on AGB, and for further information you should study the Standard & Poor tear sheet available from your broker.

John Hancock Investors Inc. is a second "common stock bond fund" also formed in late 1970. This outfit's purpose is also to generate income, but here the policy is to hold only 30% of total assets in the top four rated categories of bonds, while up to 50% of assets may be held in private debt (private placements), and these often have warrants or special features attached. Company may hold up to 20% of common and preferred stocks if common are acquired as exercise of equity features. Thus it seems to me that this fund (JHI) may be somewhat more speculative than AGB, although it yields around 7.5%, which is a

By William J. Eaton
Of Our Washington Bureau

WASHINGTON — President Nixon came out second best Monday to Pierre-Paul Schweitzer, managing director of the International Monetary Fund, in back-to-back appearances before the world's leading bankers.

U.S. plans to block Schweitzer's reappointment to a third five-year term next fall have stirred angry opposition from many of the IMF's 124 member nations.

MR. NIXON received only brief, tepid applause as he entered the hall and was introduced to speak at the opening session of the IMF and the World Bank's annual meeting.

His 20-minute speech was not interrupted for applause. Delegates clapped politely when he concluded.

In contrast, the bankers and financial ministers gave Schweitzer a warm, enthusiastic reception. Their applause was long and strong — lasting nearly two minutes — when he stepped to the podium following the President's departure.

THE RECEPTIONS for Mr. Nixon and Schweitzer seemed to be a clear demonstration of support for the IMF's French executive, who became unpopular with the United States when he advocated a devaluation of the dollar last fall before this country was willing to take such a step.

Treasury Sec. George P. Shultz has said the United States wants "a new person" to head the IMF during a new round of discussions concerning international monetary reform.

But Schweitzer, 60, said he has no plans to quit and he has drawn support from Karl Klasen, president of the West German Bundesbank.

higher yield than AGB. JHI is a subsidiary of giant John Hancock Insurance Co.. JH had recent net assets of $24.62 per share and the stock is now selling at about asset price. JHI yields over 7%.

Third, is Mutual of Omaha Interest Shares (MUO), formed in January of this year. Here, 80% of assets go to high-grade bonds, up to 20% of assets in lesser-grade bonds but no more than 10% of assets may be in privately issued bonds. Purpose of the fund is to earn as high a rate of interest as they can, within the framework of safety. On June 30, 1972, MUO's net assets were $18.28, and the stock now sells around assets. Here as in AGB, dividends are paid monthly. The investment advisor to MUO is a subsidiary of Mutual of Omaha Insurance Co. MUO yields around 7%.

Finally, we have Drexel Bond-Debenture Trading Fund (DBF), which is a somewhat differently oriented fund. Although 75% of DBF's assets go to high-grade bonds and the remainder may go to lower-grade bonds or those with special features, this fund also trades bonds for possible profits. It is run by a subsidiary of Drexel Firestone, a leading broker engaged in trading bonds. On August 11, 1972 (company was formed in Sept., 1971), DBF had net assets of $22.70, and it sells at around $22. Dividends are paid monthly and any trading profits are distributed once a year. DBF yield is about 6.7%.

What I have given here is just a brief outline of this new kind of fund, but they make sense to me, and I would prefer them for the average subscriber rather than odd-lots of a few bonds. Although interest rates may well go higher, on the great sweep of history we are in an area of astoundingly high interest rates. Ultimately, interest rates will come down. When that occurs, these funds should move up, since to a large extent their price will tend to stay in line with their yield (which depends very much on bond interest rates). Thus, theoretically, if AGB now yields 7% and sells for 28, ten years from now it could yield 3.5% (assuming a new bull market in bonds) and sell for say 50.

At any rate, I like these funds, and subscribers might investigate further on their own.

GOLD-SILVER: As seen on the weekly chart, the London gold price is back over $65, and silver is pushing $1.80. The major gold indices are now starting to edge up again.

I include this section from the September Bank Credit Analyst (1245 Sherbrooke St. W., Montreal, Canada 109). This piece on SDR's I consider outstanding; it is part of one of the best gold commentaries (in the Sept. edition) I have seen in years.

Gold and International Monetary Reform

A major question raised by the ongoing attempts of the major countries to revamp the international monetary system is whether gold's traditional economic role can be upset by the "reformers" who would like to see Special Drawing Rights (SDR's), which are man-made and man-controlled, replace gold as the principal reserve asset of monetary institutions.* Attempts along these lines have already been made with the initial distribution of some $10 billion of SDR's, which were superfluous and only added to the world's monetary inflation as they coincided with the addition of some $38 billion to world reserves. Further attempts to increase SDR's can be expected, but to assume from this that they will replace gold is pure folly. SDR's, to the extent that they play a continuing role in international finance, would cause their own demise since their creation will be at the mercy of the totally political IMF. They will be created to excess just as surely as individual countries create their own domestic currencies to excess. Since SDR's are used only to settle payments deficits, they will end up in the central banks of surplus countries. As such, they would increasingly be regarded as worse than even dollar reserves since they cannot be spent but only unloaded by deficit countries on to surplus. This naturally would place great pressure on surplus countries to out-inflate deficit countries so that they could get rid of their excessive SDR holdings. Although SDR's are denominated in gold, they are not convertible into gold and this weakness is sufficiently great to ensure that in the long-run SDR's will be relegated to the monetary museum as a curiosity, symptomatic of man's ever futile attempts to manage money and replace gold with his paper.

SDR's could only be an acceptable partial substitute for gold if there was (1) a world market for them where prices were quoted on a regular basis and (2) complete confidence that they could be sold in any size at any time. SDR's will never have these properties while gold has always had them. Gold's market has never been removed by political upheavals, war, controls, etc. Much as some people would like to ignore this quality, it is absolutely essential if an asset is to have serious credibility as a reserve medium. It is hard to imagine that any country, particularly the U.S., could seriously contemplate having to rely on SDR's to finance strategic imports during a time of war or other major international stress. Gold's great quality is that it is apolitical. It is an attractive asset regardless of the hands from which it comes. And like any real money, it can be exchanged for other currencies or goods with little or no trace. The same is not true of SDR's.